Report

of the

Examination of

Luck Mutual Insurance Company

Luck, Wisconsin

As of December 31, 2002

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, *Governor*
Jorge Gomez, *Commissioner*

Wisconsin.gov

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: information@oci.state.wi.us
Web Address: oci.wi.gov

May 16, 2003

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2002, of the affairs and financial condition of

LUCK MUTUAL INSURANCE COMPANY
Luck, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The last examination of this company was made in 1998 as of December 31, 1997. The current examination covered the intervening time period ending December 31, 2002, and included a review of such subsequent transactions deemed essential to complete this examination.

The Summary of Examination Results contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on August 27, 1881, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Luck Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used. On September 1, 1997, Alden and Black Brook Mutual Insurance Company merged into Luck Mutual Insurance Company.

During the period under examination, there was one amendment to the articles of incorporation and no amendments to the bylaws. In April 1999, the articles of incorporation were amended to add Washburn County to the authorized territory.

A review of the certificate of authority revealed that the company is currently licensed to write business in the following counties:

Barron, Burnett, Chippewa, Dunn, Eau Claire, Pierce, Polk, St. Croix, and Washburn.

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements that is a continuous renewal policy for terms of quarterly, semiannual, and annual with premiums payable on the advance premium basis. Policy fees are not charged policyholders, but the company does charge a $5.00 installment fee.

Business of the company is acquired through eight agents, six of whom are directors of the company. Agents receive a flat 14% commission on property and liability premiums on new and renewal business. Agents do not receive commission on fees, surcharges, or premium from a policy adjustment factor.

Agents have authority to adjust losses up to $500.00. Losses in excess of this amount may be adjusted by the agent after approval by the Claims Committee. However, most losses above $500 are adjusted by an independent adjuster. Agents who adjust losses receive $12.00 per hour and $.35 per mile.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors currently consists of eight members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Darold Nelson *	Farmer	Frederic, WI	2004
Duane Solum *	Farmer	Deer Park, WI	2004
Leon Helgeson	Farmer	Clear Lake, WI	2005
Guy Foltz *	Cabinet Maker	Luck, WI	2005
Gunnar Nielsen *	Farmer	Luck, WI	2005
Glen Wright *	Farmer	Amery, WI	2006
Kevin Holm *	Co-manager/Agent	Luck, WI	2006
Tom Dorsey	Retired	New Richmond, WI	2006

Directors who are also agents are identified with an asterisk.

Members of the board currently receive $50.00 for each meeting attended and $.35 for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified.

Officers serving at the present time are as follows:

Name	Office	2003 Salary
Gunnar Nielsen	President	$3,000
Kevin Holm	Vice-President	0
Glen Wright	Secretary/Treasurer	0

Starting in January 2002 the company has two co-managers. The co-managers are Jill Cook whose salary is $34,080, and Kevin Holm whose salary is $22,880.00.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Claims Committee
Gunnar Nielsen, Chairman
Kevin Holm
Glen Wright
Guy Foltz

Underwriting Committee
Gunnar Nielsen
Kevin Holm
Glen Wright
Leon Helgeson
Darold Nelson

Rate Committee
Gunnar Nielsen
Kevin Holm
Glen Wright

Executive Committee
Gunnar Nielsen
Kevin Holm
Glen Wright
Darold Nelson

Investment Committee
Gunnar Nielsen
Kevin Holm
Glen Wright

Growth of Company

The growth of the company during the past five years as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Net Losses and LAE Incurred	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2002	$528,651	$308,461	1,519	$51,386	$1,146,009	$640,556
2001	406,233	285,639	1,471	(33,459)	1,115,008	653,760
2000	420,138	240,073	1,486	12,473	1,145,133	707,437
1999	439,121	288,767	1,615	6,172	1,054,124	613,096
1998	395,001	253,901	1,655	(12,635)	1,106,550	631,989

The ratios of premiums written, gross and net, to surplus as regards policyholders during the past five years were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios Gross	Writings Ratios Net
2002	$838,840	$588,361	$640,556	131%	92%
2001	739,377	420,523	653,760	112	64
2000	712,454	428,931	707,437	101	61
1999	734,326	425,327	613,096	120	69
1998	734,911	401,518	631,989	114	64

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Composite Ratio
2002	$308,461	$207,342	$528,651	58%	35%	93%
2001	285,639	183,986	406,233	70	44	114
2000	240,073	186,803	420,138	57	44	101
1999	288,767	186,093	439,121	66	44	110
1998	253,901	193,611	395,001	64	48	112

The company had a net income in three of the five years under examination. 2002 was the only year since 1993 in which the company showed an underwriting gain, and a composite ratio below 100%. The expense ratio in 2002, 35%, was the lowest in over 20 years. This was due to a 13% increase in gross premiums written and a decrease in reinsurance premiums ceded resulting in a 30% increase in net premiums written while net underwriting expenses increased only 12.7% over 2001. Surplus decreased in 2002 due to net unrealized capital losses of $(67,457), mostly from one stock.

The policy count increased in 2002 for the first time in five years to 1,519 policies. However, there were still 185 less policies in force in 2002 than in 1997, after the merger with Alden and Black Brook Mutual Insurance Company. The increase in gross premiums written in 2002 of $99,463 was the largest increase in premiums since the merger in 1997.

II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed, there is currently one ceding treaty with five coverage sections. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2003
Termination provisions:	Either party may terminate this contract as of any subsequent January 1, by giving to the other party at least 90 days' advance notice in writing.

The coverages provided under this treaty are summarized as follows:

1. Type of contract: Class A Casualty Excess of Loss

   Lines reinsured: Casualty business

   Company's retention: $750 in respect to each and every loss occurrence.
   $1,000 deductible where raw milk contamination occurs on an insured dairy farm if there is no dairy quality assurance program.

   Coverage: 100% of each and every loss occurrence, including LAE, in excess of the company's retention subject to the maximum policy limits of:

   a. $1,000,000 per occurrence, single limit or combined for bodily injury and property damage liability.

   b. $1,000,000 split limits, in any combination of bodily injury and property damage liability.

   c. $5,000 for medical payments, per person; $25,000 per accident.

   Reinsurance premium: 62.5% of the premium written

2. Type of contract: Class B First Surplus

   Lines reinsured: All property business

   Company's retention: If net retention is $300,000 or more on a risk, the Company may cede on a pro rata basis, and the Reinsurer is obligated to accept up to $800,000. If net retention is $300,000 or less on a risk, the Company may cede on a pro rata basis, and the Reinsurer is obligated to accept up to 50% of such risk.
   Annual aggregate deductible amount equal to 10% of the loss and LAE otherwise recoverable, unless waived.

	Coverage:	Pro rata portion of each and every loss, including LAE, corresponding to the amount of the risk ceded.
	Reinsurance premium:	The pro rata portion of all premiums, fees and assessments charged by the Company corresponding to the amount of each risk ceded. Company pays reinsurer 100% of the unearned premium as of January 1, 2003.
	Ceding commission:	Provisional commission of 15% of the ceded premium. Minimum commission of 15% and maximum commission of 35%. Any amount above a 65% loss ratio or below a 45% loss ratio is carried forward.
3.	Type of contract:	Class C-1 Excess of Loss First Layer
	Lines reinsured:	All property business
	Company's retention:	$30,000 per loss per occurrence. Annual aggregate deductible of $25,000.
	Coverage:	$70,000 excess of retention including loss adjusting expenses.
	Reinsurance premium:	Net premium written multiplied by the sum of four years' losses incurred divided by the total net premiums written for the same period multiplied by a factor of 100/80ths. Minimum Rate: 6% of the current net written premiums. Maximum Rate: 23.2% of the current net premiums written. Rate for current annual period is 8.13%. Deposit premium $51,000.
4.	Type of contract:	Class C-2 Second Excess of Loss Second Layer
	Lines reinsured:	All property business
	Company's retention:	$100,000 per loss per occurrence
	Coverage:	$200,000 excess of retention including loss adjustment expenses for each and every loss occurrence.
	Reinsurance premium:	1.80% of NPW. Deposit premium of $11,100 with minimum premium of $8,900.
5.	Type of contract:	Class D/E First Aggregate Stop Loss and Catastrophe
	Lines reinsured:	All Property Business
	Company's retention:	Part A – Catastrophe: $75,000 of losses excluding LAE arising out of each 72 hour loss occurrence. Part B – Stop Loss: Annual aggregate net losses up to 75% of the Company's net premiums written, including LAE; subject to a minimum retention of $410,000.

Coverage:	Part A: 100% of losses including LAE in excess of Company's retention, up to $250,000 for any one 72 hour loss occurrence and up to $500,000 during each annual period. Part B: 100% of the annual aggregate net losses in excess of the retention, including LAE.
Reinsurance premium:	Net premiums written multiplied by the sum of the eight years' losses incurred divided by the total of the net premiums written for the same period, multiplied by the factor of 100/80ths. Minimum rate is 8.5% and maximum rate of 25%, of the current net written premiums. Deposit premium of $55,800, minimum premium $45,000.

III. FINANCIAL DATA

The following financial statements were filed with the Commissioner of Insurance in the company's annual statement at December 31, 2002. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Luck Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2002

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in Company's Office	$ 100	$	$	$ 100
Cash Deposited in Checking Account	1,234			1,234
Cash Deposited at Interest	142,932			142,932
Bonds (at Amortized Cost)	539,906			539,906
Stocks or Mutual Fund Investments (at Market)	330,961			330,961
Real Estate	58,799			58,799
Premiums and Agents' Balances and Installments:				
In Course of Collection	7,999			7,999
Deferred and Not Yet Due	89,087			89,087
Investment Income Accrued		11,596		11,596
Reinsurance Recoverable on Paid Losses and LAE	(39,975)			(39,975)
Electronic Data Processing Equipment	1,598			1,598
Other Assets:				
Expense Related:				
Reinsurance Commission Receivable	1,772			1,772
Furniture and Fixtures	1,212		1,212	0
Other Nonadmitted Assets:				
Software	3,576		3,576	0
Non-Admitted Investments	88		88	0
TOTALS	$1,139,289	$11,596	$4,876	$1,146,009

Liabilities and Surplus

Net Unpaid Losses	$ 25,151
Unpaid Loss Adjustment Expenses	1,277
Commissions Payable	21,227
Fire Department Dues Payable	216
Unearned Premiums	405,523
Reinsurance Payable	44,499
Amounts Withheld for the Account of Others	1,928
Payroll Taxes Payable (Employer's Portion)	419
Other Liabilities:	
Expense Related:	
Accounts Payable	1,323
Accrued Property Tax	3,890
TOTAL LIABILITIES	505,453
Policyholders' Surplus	640,556
TOTAL	$1,146,009

Luck Mutual Insurance Company
Statement of Operations
For the Year 2002

Net Premiums and Assessments Earned		$528,651
Deduct:		
Net Losses Incurred	$282,490	
Net Loss Adjustment Expenses Incurred	25,971	
Other Underwriting Expenses Incurred	207,342	
Total Losses and Expenses Incurred		515,803
Net Underwriting Gain		12,848
Net Investment Income:		
Net Investment Income Earned	38,292	
Net Realized Capital Gains	(245)	
Total Investment Income		38,047
Other Income:		
Miscellaneous Income		491
Net Income (Loss) Before Policyholder Dividends and Before Federal Income Taxes		51,386
Net Income		$ 51,386

Luck Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2002

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2002	**2001**	**2000**	**1999**	**1998**
Surplus, beginning of year	$653,760	$707,437	$613,096	$631,989	$569,962
Net income	51,386	(33,458)	12,473	6,173	(12,635)
Net unrealized capital gains or (losses)	(67,457)	(23,152)	79,598	(12,704)	67,143
Change in non-admitted assets	2,867	2,933	2,270	(12,362)	7,519
Surplus, end year	$640,556	$653,760	$707,473	$613,096	$631,989

Reconciliation of Policyholders' Surplus

A reconciliation of the policyholders' surplus as reported by the company in its filed annual statement and as determined by the examination is detailed in the following schedule:

Policyholders' Surplus per December 31, 2002, Annual			$640,556
Item	**Increase**	**Decrease**	
Real Estate		$4,587	
Decrease to Surplus per Examination			(4,587)
Policyholders' Surplus per Examination			$635,969

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records — It is recommended that the company report biographical data relating to company officers and directors in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

   Action — Compliance.

2. Business Plan — It is recommended that the company provide a written business plan to the Office of the Commissioner of Insurance (OCI) pursuant to s. 601.42, Wis. Stat., within 90 days after the adoption of this examination report.

   Action — Compliance.

3. EDP Environment — It is recommended that the company develop or obtain manuals documenting the use of its software.

   Action — Compliance.

4. Transition into New Investment Rule — It is recommended that the company make no additional type 2 investments until the company meets the required amount of type 1 investments, pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.

   Action — Compliance.

5. Invested Assets — It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

   Action — Noncompliance. Further comment on this recommendation can be found in the "Summary of Current Examination Results" section of this report.

6. Book Value of Bonds — It is again recommended that the company comply with s. Ins 6.20 (6) 3 and 4, Wis. Adm. Code, and invest in only those securities permitted by this rule.

   Action — Compliance

7. Net Unpaid Losses — It is recommended that the company adopt procedures for timely settlement of claims in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

   Action — Compliance.

8. Unpaid Loss Adjustment Expenses — It is recommended that the company adopt a method of estimating loss adjustment expenses that directly considers probable expenses based on past experience.

   Action — The company is considered in compliance. The company used only one year of experience, but the amount estimated by the company was reasonable.

9. Class C-P Excess of Loss Payback – It is recommended that the company record the balance of the class CP excess of loss payback on the balance sheet in future.

Action — Compliance.

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and any committees thereof, were reviewed for the period under examination and also for the subsequent period. The following was noted in the review of the board meetings:

1. The minutes of the board of directors since June 19, 2002 and the annual policyholder meeting for 2003 have not been signed by the Secretary.
2. Committees of the board of directors are not appointed annually by the board, and the appointment of committees is not noted in the minutes.

It is recommended that the Secretary sign all minutes of the board of directors and all annual and special policyholder meetings. It is recommended that board committees be appointed annually, and be noted in the board minutes.

The duties of the Secretary/Treasurer as stated in the by-laws have been handled by the co-managers of the company since February 2002. It is recommended that the by-laws be amended to indicate that the board of directors can appoint a manager/co-managers to perform the duties of the Secretary and Treasurer stated in the by-laws. Amendments to by-laws are not effective until they are filed with and approved by the commissioner as required by s. 612.04, Wis. Stat.

There are currently eight directors on the board of directors. The articles of incorporation state that the number of directors shall be fixed by a resolution adopted by a majority of the directors in office and shall not be less than seven nor more than 15 directors. The board did not adopt a resolution when the number of directors decreased from nine to eight. The sentence of Article III on the number of directors being more than nine and reducing the number back to nine was never filed with this office. It is recommended that the board of directors adopt a resolution fixing the number of directors to comply with Article III of its articles of incorporation, and that changes in the articles of incorporation be approved by the policyholders and be filed with the commissioner. The company may amend Article III at its annual or a special membership meeting. Amendments to the articles are not effective until they are filed with and approved by the commissioner as required by s. 612.04 (2), Wis. Stat.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

It was noted that the new co-manager, who is not a director, had not completed the conflict of interest questionnaire. This was done during the examination. As noted above, the Commissioner's directive applies to officers, directors, and key employees, so the co-manager should complete the questionnaire annually.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limit
Professional Liability	$1,000,000 each loss and in aggregate
Worker's compensation	Wisconsin statutory
Employers Liability	
Each accident	100,000
Policy limit	500,000
Each employee	100,000
Fidelity Bond	100,000
Property	
Home office building	100,000
Commercial personal property	25,000
Theft	25,000
Vandalism & malicious mischief	125,000

Commercial General Liability	
Liability-bodily injury and property damage	1,000,000
Medical – per person	1,000
Medical – per occurrence	1,000,000
Fire legal liability	50,000
General aggregate limit	2,000,000
Incidental Lessor's Risk	1,000,000

Agent's errors and omissions insurance of $1 million is obtained by the company for its agents, and the company is reimbursed by the agents. One independent agent obtains his own coverage.

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing. The company's 2001 Business Plan stated that photographs were to be included by 2003. In accordance with s. 612.04 (2), Wis. Stat., no change in the business plan is effective until approved by the commissioner, nor may a town mutual depart from its business plan except with the commissioner's approval. The rating committee minutes of November 27, 2001, noted that all applications must be accompanied by photos of all buildings insured before coverage can be bound and the policy processed. If the office arranges for photos, those costs are to be deducted from the commission of the agent. It was noted that not all procedures and guidelines were consistent on the various company documents.

The company has a valuation guide to properly value homeowner policies. The underwriting guide and the "Policy Handling Procedures and Guidelines" do not contain language on using the homeowner valuation guide. Also, the valuation guide is not being used by all agents. It is recommended that photographs of all insured property be included in each policy file at the time of application and/or at renewal, that the homeowner valuation guide be used by all agents, and that underwriting guidelines and policy procedures require the use of the homeowner valuation guide. The company has bi-monthly agent meetings to help in the communication of underwriting rules, policy procedures, rates, claims, and any other relevant information.

The company charges certain amounts that the company considers fully earned when paid. These include the policy premium adjustment factor, fees (wood-burning stove and rental house), and surcharges (large risk, snowmobile, and claims). These amounts are considered to be premiums, and they are not fully earned when received. The company has not been including these premiums in the calculation of any refunds to policyholders. It is recommended that the company include the premium adjustment factor, fees (wood-burning stove and rental house), and surcharges (large risk, snowmobile, and claims) as premium in the calculation of any refund to policyholders, and satisfy the requirements of s. Ins 6.10, Wis. Adm. Code.

The company does not have a formal inspection procedure for both new and renewal business. It is recommended that the company establish a formal inspection procedure for new and renewal business, whereby a sampling of new applications and of renewal business is inspected by committee members independent of the risk or by a professional independent inspector.

Claims Adjusting

The company has a claims adjusting committee. According to s. 612.13(4), Wis. Stat., the committee is to consist of at least three directors and shall be appointed annually by the board of directors. The function of this committee is to adjust or supervise the adjustment of losses. The committee has four directors as members, the company's three officers plus another director, all of whom are agents and write 71% of the company's premium.

Starting in 2002, only the President and the Vice-president have attended the claim committee meetings. The minutes of the claims committee are read and approved at the board of directors meetings. Also, claims pending and paid are reviewed and approved as presented to the board. As noted previously, the committee is not appointed annually by the board and noted in the board of directors' minutes. It is recommended that in accordance with s. 612.13 (4), Wis. Stat., that the claims adjusting committee be appointed annually by the board of directors and is noted in the board minutes. It is also recommended that at least three board members be appointed to the claims adjusting committee, and that the board replace any committee member who has unsatisfactory attendance.

Accounts and Records

The examiners' review of the company's records indicated that the company is not in complete compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is not maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

The policy register with in force detail does not include premium amounts by policyholder for the policy adjustment factor, fees (wood-burning stove and rental house), and surcharges (large risk, snowmobile, and claims). The company could not provide a report by policy detail that included this information. It is recommended that pursuant to s. Ins 13.05(3), Wis. Adm. Code, that the company maintain detail records by policy number to include various premium adjustments, assessments, fees, and surcharges in the policy in force register or other reports. The company's in force premium by detail on the policy register does not match what is recorded on the annual statement. The insurance in force and the policy count also did not agree with the annual statement. The premium in force and the policy count on the unearned premium report did agree with the annual statement.

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2002.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's Electronic Data Processing environment. Access to the computers is limited to people authorized to use the computers. Company personnel back up the computers daily and the backed-up data is kept off-site. A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations. The company has manuals documenting the use of its software for seldom-used applications, training, or when staff turnover occurs, and the use of technical assistance from its software vendor.

Disaster Recovery Plan

A disaster recovery plan identifies steps to be performed in case the company loses a key employee, is not able to access its computer, information on its computer was lost, or the office building was destroyed, to name a few contingencies. The company has developed a disaster recovery plan. However, the company's disaster recovery plan is not complete as it does not include a plan for the loss of a key employee(s). It is recommended that the company revise its disaster recovery plan to include a plan concerning the loss of a key employee(s).

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is not in compliance with these requirements. The examiner's review disclosed that the company has all its bonds with a brokerage firm or a custodian for a brokerage firm. Also, a mutual fund investment and a certificate of deposit are being held by brokerage firms. The securities are not held under a proper custodial agreement, with a bank or banking and trust company that meets the standards and provisions established by the NAIC Examiners Handbook. The company must obtain possession of all their investments and place them in a safe or in a safety deposit box, or with a bank or banking and trust company with a proper custodial agreement. It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

Investment Rule Compliance

The investment rule for town mutual insurers, s. Ins. 6.20(6), Wis. Adm. Code, allows a town mutual insurance company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as “Type 2”) provided that the town mutual has a sufficient amount of lower risk investments (referred to as “Type 1”). A town mutual may invest in Type 2 securities only if it has sufficient Type 1 investments.

Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$805,453
2.	Liabilities plus 33% of gross premiums written	782,270
3.	Liabilities plus 50% of net premiums written	799,634
4.	Amount required (greater of 1, 2, or 3)	805,453
5.	Amount of Type 1 investments as of 12/31/2002	720,067
6.	Excess or (deficiency)	(85,386)

The company does not have sufficient Type 1 investments.

A town mutual is required to divest itself of any investment which does not comply with the rule within three years of its noncompliance, unless the Commissioner permits a longer period or requires a shorter period. Currently, the company has two investments, with a statement value of $2,841, which are not in compliance with the foregoing requirement. These are two bond investments made in 1998 which were investment grade and Type 1 assets when purchased. However, because they dropped below investment grade they have become Type 2 investments. The company has three years from when the bonds dropped below investment grade to dispose of them. Since 1998, the company has not made any additional Type 2 investments, pursuant to s. Ins 6.20 (6) (c), Wis. Adm. Code.

ASSETS

Cash and Invested Cash **$151,266**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 100
Cash deposited in banks-checking accounts	1,234
Cash deposited in banks at interest	149,932
Total	$151,266

Cash in the company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of two accounts maintained in one bank and with a brokerage firm. Verification of the bank account balance was made by obtaining confirmation directly from the depository and reconciling the amount shown thereon to company records. The cash balance with the brokerage firm account was traced to the year end statement.

Cash deposited in banks represents the aggregate of two deposits in two depositories. One was a savings account at a bank, and the other was a certificate of deposit held at a brokerage firm. The deposit at the bank was verified by direct confirmation with the depository. The certificate of deposit at the brokerage firm was traced to the broker’s year end statement. Interest received during the year 2002 totaled $7,541 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 1.47% to 5.80%. Accrued interest on cash deposits totaled $1,426 at year-end.

Book Value of Bonds **$539,906**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2002. Bonds owned by the company are located in a bank safety deposit box, and at a brokerage firm and at a custodian for a brokerage firm.

Bonds at the safety deposit box were physically inspected by the examiners. Bonds at the brokerage firms were traced to the year end broker statements. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds at year end 2002 was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers, except as regards custody, as discussed earlier in this report. The company has two Type II bonds valued at $2,841.00. Interest received during 2002 on bonds amounted to $25,159 and was traced to cash receipts records. Accrued interest of $10,170 at December 31, 2002, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments $330,961

The above asset consists of the aggregate market value of $271,929 in stocks and $59,032 in mutual funds held by the company as of December 31, 2002. Stocks owned by the company are located in a bank safe deposit box, and a money market mutual fund is being held by a brokerage firm.

Stock certificates were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2002 on a mutual fund amounted to $729 and were traced to cash receipts records. There were no accrued dividends at December 31, 2002.

Book Value of Real Estate $54,212

The above amount represents the company's investment in real estate as of December 31, 2002, as determined by this examination. The annual statement amount was $58,799.00. The company's real estate holdings consisted of the company’s home office purchased in 1989 and the building owned by the former Alden and Black Brook Mutual Insurance Company in Amery, Wisconsin.

The required documents supporting the validity of this investment were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Rental income for both buildings was $17,101.00.

A review was done of the calculation for depreciation on the buildings. Real estate depreciation is calculated using the straight-line method. The book value of real estate was overstated as the depreciation on the Amery building was understated by $4,587 from improvements on a new roof, siding, and windows. It is recommended that depreciation on real estate be calculated properly. A decrease for the $4,587 difference was made to the examination surplus in the “Reconciliation of Policyholders’ Surplus” section of this report.

Premiums, Agents' Balances, and Installments **$97,086**

The above ledger asset represents $7,999 for amounts due from policyholders and $89,087 for deferred and not yet due premiums at year-end. A review of reports for individual policyholder premium and deferred premiums verified the amount of this asset. A review of the premiums payable noted that premiums and late fees in excess of 90 days past due were included in the receivable. It is recommended that, in accordance with annual statement instructions, amounts over 90 days past due be nonadmitted in future annual statement filings.

Investment Income Due and Accrued **$11,596**

Interest due and accrued on the various assets of the company at December 31, 2002, consists of the following:

Bonds	$10,170
Cash at Interest	1,426
Total	$11,596

Reinsurance Recoverable on Paid Losses and LAE **$(39,975)**

The above negative asset, as of December 31, 2002, represents reinsurance recovered in 2002 from claims in 2001. It is on catastrophe coverage claims which the company decided to pay back to the reinsurer. Subsequent cash disbursements and reinsurance accountings verified the amount. The $39,975 was included in 2001 net income and was deducted from 2002 net income.

Reinsurance Commission Receivable **$1,772**

The above asset represents the net reinsurance commission receivable from the company’s reinsurer as of December 31, 2002. It consists of the following:

Class “B” – First Surplus	$ 626
Prior year Deferred First Surplus	1,189
Change in Deferred First Surplus	(43)
Total	$1,772

A review of year-end accountings with the reinsurer and subsequent receipts verified the amount.

Electronic Data Processing Equipment **$1,598**

This asset consists of $1.598 of computer equipment, minus depreciation, owned by the company at December 31, 2002. The computer equipment is depreciated straight-line over five years.

Furniture, and Fixtures **$0**

This asset consists of $1,212 of equipment and furniture owned by the company as of December 31, 2002. In accordance with annual statement requirements, this amount has been deducted as an asset not admitted.

Software **$0**

This asset consists of $3,576 of computer software owned by the company as of December 31, 2002. In accordance with annual statement requirements, non-operating software is to be deducted as an asset not admitted. The company also included operating software in this asset, which was also non-admitted by the company, although the town mutual instructions would allow this portion to be admitted.

Non-Admitted Investments **$0**

This asset consists of $88 of a dividend receivable from a cooperative that is over 90 days past due at December 31, 2002. In accordance with annual statement requirements, this amount has been deducted as an asset not admitted.

LIABILITIES AND SURPLUS

Net Unpaid Losses **$25,151**

This liability represents losses incurred on or prior to December 31, 2002, and remaining unpaid as of that date. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiners' Development	Difference
Incurred But Unpaid Losses	$62,763	$92,013	$(29,250)
Less:			
Reinsurance Recoverable on Unpaid Losses	37,612	66,488	(28,876)
Net Unpaid Losses	$25,151	$25,525	$ (374)

The examiners developed this liability by totaling actual loss payments made through the development period on those losses incurred on or prior to December 31, 2002. To the actual paid loss figures was added an estimated amount for those 2002 and prior losses remaining unpaid at the examination date. The above difference of $374 was not considered material for purposes of this examination. Therefore, this difference is not used to adjust policyholders' surplus.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated, evaluated properly, and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

Unpaid Loss Adjustment Expenses **$1,277**

This liability represents the company's estimate for loss adjustment expenses (LAE) to be paid in order to settle losses which were incurred prior to December 31, 2002, but which remained unpaid as of year-end.

The methodology used by the company in establishing this liability is by estimating the amounts to be paid to the outside adjuster. The foregoing method was used by the company because using a ratio of paid LAE to paid losses produced an inadequate reserve.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be acceptable. The examination development was $225 more than the annual statement amount. The amount was not considered material, so the difference is not used to adjust policyholders surplus for purposes of this examination.

Unearned Premiums **$405,523**

This liability represents the reserve established for unearned premiums as required by s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology. This method of calculation has been previously approved by the Office of Commissioner of Insurance.

The unearned premium report included policies that were canceled and policies that had no unearned premium, but still had a number of outstanding unearned days. It is recommended that the company accurately report unearned premiums by excluding canceled policies and by including policies with outstanding unearned days. It is suggested that the company develop procedures to review monthly the details of the unearned premium report and the policy in force register to identify possible clerical or program errors.

Reinsurance Payable **$44,499**

This liability consists of amounts due to the company's reinsurer at December 31, 2002, relating to transactions which occurred on or prior to that date.

Class “A: Liability	$10,281
Class “B” First Surplus	4,173
Class “C” C-1 Layer	12,775
Class “C” C-2 Layer	3,275
Class “D/E” Stop Loss	9,125
Class “D/E” 72 Hour CAT	(2,772)
Prior year Deferred First Surplus	7,929
Change in Deferred First Surplus	(287)
Total	$44,499

Cash disbursement and receipt records and reinsurance accountings verified the liability amount.

Fire Department Dues Payable **$216**

This liability represents the fire department dues payable at December 31, 2002. The examiners reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The actual amount paid was verified to cash disbursement records.

Commissions Payable **$21,227**

This liability represents the commission payable at December 31, 2002. The examiners recalculated individual commissions on a sample basis, tied-out detail of agent's commission payable total as of year-end, confirmed payments to cancelled checks, and verified amounts to detailed listings of commission payable.

Amounts Withheld for the Account of Others **$1,928**

This liability represents employee payroll deductions in the possession of the company at December 31, 2002. Supporting records and subsequent cash disbursements verified this item.

Payroll Taxes Payable **$419**

This liability represents the company's portion of payroll taxes incurred prior to December 31, 2002, which had not yet been paid. Supporting records and subsequent cash disbursements verified this item.

Accounts Payable **$1,323**

This liability represents the company's estimate for unpaid general expenses at December 31, 2002. Supporting records and subsequent cash disbursements verified the items and that the liability was reasonable.

Accrued Property Taxes **$3,890**

This liability represents the company's unpaid property taxes at December 31, 2002. Supporting records and subsequent cash disbursements verified this item.

V. CONCLUSION

The examination report made 15 recommendations and one suggestion that pertain to corporate records, underwriting, accounting records, depreciation on real estate, and custody and control of invested assets. The recommendation regarding custody and control of invested assets was also recommended in the two prior examination reports. There was one adjustment decreasing surplus for the examination by $4,587.00.

The company has not shown steady growth and profitability over the last five years. However, 2002 was the first time in nine years that the company had an underwriting gain and that the composite ratio was below 100%. Also, 2002 showed the first gain in policies in force in five years, but the 1,519 policies were still less than the 1,704 policies in 1997 after the merger with Alden and Black Brook Mutual Insurance Company. The increase in gross premiums written in 2002 of $99,463 was the largest increase in premiums since the aforementioned merger in 1997. However, surplus still decreased in 2002 to $640,556 due to unrealized capital losses of $(67,457). The company has had a Type 1 investment deficiency, but it is down to $(85,386).00. The company has two Type II bonds.

The previous examination recommended that the company have a written business plan to "achieve a return to profitability." Yearly review and updating of the company's business plan would be very helpful. The underwriting guidelines currently being used, including pricing of policies, and the use of a professional adjuster should help the company. Having photographs in all policy files and use of a valuation guide for homeowner policies should also help. The company's bi-monthly agent meetings is a positive step by the company. The company is now using a continuous renewal policy. In 2002, the company increased its retention on its Class B reinsurance from $200,000 to $300,000.00.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1.	Page 18	Corporate Records—It is recommended that the Secretary sign all minutes of the board of directors and all annual and special policyholder meetings.
2.	Page 18	Corporate Records—It is recommended that board committees be appointed annually, and be noted in the board minutes.
3.	Page 18	Corporate Records—It is recommended that the by-laws be amended to indicate that the board of directors can appoint a manager/co-managers to perform the duties of the Secretary and Treasurer stated in the by-laws.
4.	Page 18	Corporate Records—It is recommended that the board of directors adopt a resolution fixing the number of directors to comply with Article III of its articles of incorporation, and that changes in the articles of incorporation be approved by the policyholders and be filed with the commissioner. The company may amend Article III at its annual or a special membership meeting.
5.	Page 20	Underwriting—It is recommended that photographs of all insured property be included in each policy file at the time of application and/or at renewal, that the homeowner valuation guide be used by all agents, and that underwriting guidelines and policy procedures require the use of the homeowner valuation guide.
6.	Page 21	Underwriting—It is recommended that the company include the premium adjustment factor, fees (wood-burning stove and rental house), and surcharges (large risk, snowmobile, and claims) as premium in the calculation of any refund to policyholders, and satisfy the requirements of s. Ins 6.10, Wis. Adm. Code.
7.	Page 21	Underwriting—It is recommended that the company establish a formal inspection procedure for new and renewal business, whereby a sampling of new applications and of renewal business is inspected by committee members independent of the risk or by a professional independent inspector.
8.	Page 21	Claims Adjusting—It is recommended that in accordance with s. 612.13 (4), Wis. Stat., that the claims adjusting committee be appointed annually by the board of directors and is noted in the board minutes.
9.	Page 21	Claims Adjusting—It is recommended that at least three board members be appointed to the claims adjusting committee, and that the board replace any committee member who has unsatisfactory attendance.
10.	Page 22	Accounts and Records—It is recommended that pursuant to s. Ins 13.05(3), Wis. Adm. Code, that the company maintain detail records by policy number to include various premium adjustments, assessments, fees, and surcharges in the policy in force register or other reports.
11.	Page 23	Disaster Recovery Plan—It is recommended that the company revise its disaster recovery plan to include a plan concerning the loss of a key employee(s).
12.	Page 24	Invested Assets—It is recommended that the company comply with s. 610.23, Wis. Stat., and s. Ins 13.05, Wis. Adm. Code, as regards custody and control of its invested assets.

13. Page 26 Book Value of Real Estate—It is recommended that depreciation on real estate be calculated properly.

14. Page 27 Premiums, Agents' Balances, and Installments—It is recommended that, in accordance with annual statement instructions, amounts over 90 days past due be nonadmitted in future annual statement filings.

15. Page 30 Unearned Premium—It is recommended that the company accurately report unearned premiums by excluding canceled policies and by including policies with outstanding unearned days.

16. Page 30 Unearned Premiums—It is suggested that the company develop procedures to review monthly the details of the unearned premium report and the policy in force register to identify possible clerical or program errors.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, John Litweiler of the Office of the Commissioner of Insurance (OCI), State of Wisconsin, participated in the examination:

Respectfully submitted,

Andrew M. Fell
Examiner-in-Charge